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Financial Management and Growth of SMEs in Jos Metropolis

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Abstract

It is evidenced that growth of industries depends on efficient financial management but most industries including small and medium scale enterprises (SMEs) face challenges and problems coming from both external and internal economic environments. Researchers have opined that apart from infrastructural limitations, entrepreneurial competence of owner-managers, the impact of multiple tax, unfriendly business environment, low managerial skills and lack of access to modern technology, non-growth oriented policies and regulations, prudent financial management is one of the key success factors for SMEs but unfortunately, many SMEs in Nigeria tend to neglect the importance of effective and efficient financial management in their businesses. Hence, the study set out to establish the impact of financial management on the growth of SMEs particularly the capital structure management of firms. The study used the baseline survey and the structured questionnaire schedule to obtain data from 40 registered SMEs trading in building materials in Bukuru, Jos Metropolis. The regression analysis result indicated that there is no relationship between capital structure management and growth of SMEs. Thus, it was recommended that managers should not focus only on capital structure of firms but other financial management variables should be considered.

Keywords: *Financial Management, Capital Structure Management, Growth, and Small and Medium Enterprises*

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Background to the Study

Small and Medium Scale Enterprises are essential ingredients in the lubrication and development of any economy as many developed and developing countries have recognized its importance of generating a considerable extent of employment opportunities, increasing industrial output which translate into increased GDP and maintenance of a significant economic growth together with rapid industrialization. (Reddy,1991; Ahmed, 2006; Oni & Daniya, 2012).

Small and medium enterprises play an important role in Nigeria's economic growth, as they constitute 97.2% of the companies in Nigeria (Ministry of Trade and Investment, 2011). 79% employment rate, 38% in export earnings and 40% on the GPD (Adelaja, 2006) after policies and programmes such as the National Directorate of Employment (1987),the National Economic Empowerment and Development Strategy (2003), National Poverty Eradication Programme (2000) etc that have been put to place over the years by the government with a view to developing Small and Medium Scale Enterprises.

Despite all the policies and programmes put in place by the Nigerian government empirical evidences shows that access to finance and poor funding, poor financial management linked to lack of accountability, infrastructural limitations, entrepreneurial competence of owner-managers, the impact of multiple tax, unfriendly business environment, low managerial skills and lack of access to modern technology, non growth-oriented policies and regulations has stunted the performance of SMEs (Olakunri, 2012; Sangosanya, 2011, Nmadu, 2009, and Kessides, 1993)

The most frequently cited problems are shortages of finance, infrastructures and power supply but the shortages of finance has recently been addressed by the Central bank of Nigeria through the approval of the sum of N500 billion Power/Manufacturing Facility whereby N300 billion was applied to power projects and N200 billion to the refinancing/restructuring of banks' existing loan portfolios to Nigerian SME/manufacturing sector). In addition to the above, the Bank has also established a N200 billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS), for promoting access to credit by SMEs in Nigeria. The overall goal of these two initiatives are to increase output, generate employment, diversify the revenue base, increase foreign exchange earnings and provide inputs for the industrial sector on a sustainable basis CBN, (2010). However, beyond raising and giving of finance, operators of SMEs need to pay particular attention to management issues on how to manage the money for the growth of the business.

It is evidenced that growth of most industries depends on efficient financial management as it can satisfactorily face any challenges, obstacles and problems coming from external and internal economic environment (Cyril, 2006; Hashim 2009,) Fong, (2006) in his study of SMEs in Malaysia opined that prudent financial management is one of the key success factors for SMEs but unfortunately, many tend to neglect the importance of financial management in their businesses. Olakunri, (2012) in Nigeria also asserted that for SMEs to remain dynamic they must employ professional managers for the continued growth of

the firm as managerial inefficiency or poor financial managerial ability affects the growth of the firm. Hence, this study examined the impact of financial management on the growth of SMEs trading in Building materials in Bukuru area of Jos metropolis, Plateau State with a focus on two practices of financial management: Capital structure management and working capital management.

The study is therefore organized around this research question

1. Does capital structure management impact on the growth of SMEs trading in Building Materials?

Financial Management and SMEs Growth

Financial management is a critical element in the management of a business. As a whole, it is concerned with the planning and controlling of firm's financial resources. It involves all the activities that enable a company to obtain capital for growth, allocate resources efficiently, maximize the income potential of the business activity and monitor results through accounting documents. Financial management helps to grow and improve the profitability position of the concern firm with the help of strongly financial control devices such as budgetary control, ratio analysis and cost volume profit analysis (Paramasivan & Subramanian, 2009). Growth purely depends on the effectiveness and proper utilization of funds by the business concern involving a well-written, comprehensive financial management plan clearly outlining the assets, debts and the current and future profit potential of your business.Growth is also the most appropriate indicator of the performance for surviving small and medium firms, an important precondition for the achievement of other financial goals of business (de Geus, 1997: 53; Storey, 1994; Reynolds, 1993; Day, 1992: 128; Phillips & Kirchhoff, 1989).

Many researchers(Mcmahon and Holmes, 1991; Atrill, 2001;Kieu 2004; and BERNAMA, 2006) have identified prudent financial management practices by SMEs as a crucial factor to its profitability, survival and well-being of small enterprises. Even weak financial management particularly poor working capital management and inadequate long-term financing is a primary cause of failure among small business (Atrill, 2001). The growth and development of the firm internally and externally is directly influenced by the financial policies adapted by the management. Hence, the growth of the firm actions determine solvency of the firm. In order words, the performance of a business enterprise is based on the number of factors, one of the main factors is firm financial strength (FS) and it directly affects the firms' growth ability. The more efficient financial management practices, the higher profitability translating to firms growth. By raising the efficiency of financial management practices therefore among SMEs can improve profitability, enhance growth potential and sustainability levels of profit.

Capital Structure Management and SMEs Growth

Capital structure is a significant managerial decision which influences shareholders returns and risk. It is the relative amount of debt and equity used in financing a firm. Many SMEs are managed by owners therefore often suffering from lack of capital base,

inability to build up revenue reserve and limited to available equity markets access. Hence, the choice of internal or external financing becomes a serious concern for these firms.

The Influence of capital structure on firm performance has been studied since 1952 with Modigliani and Miller, (1958) affirming that the capital structure is immaterial and there is no optimal capital structure based on unrealistic assumptions. However, the concept of optimal capital structure based on the Pecking Order Theory (POT) suggests that firms will initially rely on internally generated funds, then they will turn to debt finance if additional funds are needed and finally they will issue equity to cover any remaining capital requirements. As a result, the pecking order theory shows a negative relationship between leverage and profitability. The trade-off theory, taxes, bankruptcy costs and agency costs incline more profitable firms towards higher leverage. First, expected bankruptcy costs decline when profitability increases. In addition, if past profitability is a good proxy for future profitability, profitable firms can borrow more, as the likelihood of paying back the loans is greater. Secondly, the tax deductibility of corporate interest payments induces more profitable firms to finance with more debt. In the agency models of Jensen and Meckling(1976), higher leverage helps control agency problems by forcing managers to pay out more of the firms excess cash in interest payments. Therefore, the trade-off theory predicts a positive relationship between profitability and leverage.

Many researches on the capital structure of SMEs have included industry effect and its variations across this industries as a determinant of capital structure (McMahon, 2005; Abor, 2007).While other empirical studies have however focused on the impact of debt to equity mix on firm performance. In the study of US firms by Titman and Wessels (1988), a negative relationship between capital structure and firm performance existed. As such, small firms maintain less relationship with financial institutions due to the cost and risk associated with high interest rate on leverage as opposed to the larger firms who are offered competitive interest rates. Rajan and Zingales (1995), Ozkan (2001) also affirms to this and further explained that small firms are more sensitive to economic downturns and face high chance of liquidation in situations of financial distress as they have fewer resources available. As a result small firms use more short term debt than larger firms hence size must be positively related to leverage. In Ghana, Arbor, (2007) findings showed a significant positive relationship between ratio of short term debt to total assets and rate of equity among listed firms on the Ghana stock exchange suggesting that profitable firms use more short term debt to finance their business operations.

Kieu (2004) in the study of SMEs in Nigeria indicated that SMEs do not generally use financial leverage to boost their profitability as 72% of SMEs in the study sample had debt ratios less than 30%and about 10% had debt ratios more than 50%. Recently Omondi & Muturi (2013) however showed that leverage had a significant negative effect on financial performance of the firm and Umer (2014) also opined that there is a negative correlation between capital structure and profitability of the firm. But, Gill, et al., (2011) showed that short-term debt; long-term debt; and total debt had positive influence on profitability. Even in the service and manufacturing sector, the findings showed an impact of short-term debt and total debt on ROA in both sectors.

Methodology

The study used the questionnaire survey, obtaining data from 40 SMEs trading in building materials at Bukuru, Building Materials Market Jos Metropolis. The main reason for the number of respondent is because the market is relatively small and consists mainly of Igbo's a tribe in Nigeria. Data from the questionnaire was summarized with simple percentages, cross tabulation, multiple regression analysis and correlation analysis. The multiple regression analysis was used to determine the nature and significance of relationship between changes in the response variable and change in the predictor variables (determinants) identified in the study.

Model

Dependent Variables

The dependent variable is turnover/revenue: Financial performance of SMEs can be measured using a number of indicators such as revenue, profitability, liquidity and growth rate and the most frequently used measure for growth has been change in the firm's turnover, number of employees and rate of growth ((Roshanak, 2013; and Cassar and Holmes, 2003; Weinzimmer, Nystrom & Freeman, 1998; Hubbard & Bromiley, 1995; Hoy, McDougall & Dsouza, 1992; Venkatraman & Ramanujam, 1986). Hence, in this study turnover was adopted.

Independent Variables

These are the mediating factors hypothesized to affect growth. These variables constitute two categories:

1. Capital Structure: Equity, internal source (family), external source (bank) and retained earnings

Hypothesis 1

$\mathbf{H}_{o1:}$ Capital structure management has no significant impact on growth of SMEs

The model is therefore specified as follows

$Y= \beta_0 + \beta_1 X1+ \beta_2 X2+ \beta_3 X3+ \beta_4 X4+\mathcal{E}$

Where:

Y= Dependent Variable –(Annual turnover)

X1= Retained earnings

X2= Internal source- family, friends

X3= external source – bank

X4= equity

$\mathcal{E}$ = error term

$\beta_{1,}\ \beta_{2,}\ \beta_3$ and $\beta_{4,}$ = parameter estimates: slope of X1, X2, X3 and X4

$\beta_{0=}$ constant of the Multiple regression equation.

Result and Discussion

Table 1: Regression Results for Annual Turnover as Dependent Variable and Capital Structure variables

a. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.194[a]	.038	-.072	2.016

a. Predictors: (Constant), Internal source of Funds, Borrow from Family/Friends, Loan from Bank, Reinvest Profit

a. ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	5.567	4	1.392	.343	.847[b]
1	Residual	142.208	35	4.063		
	Total	147.775	39			

a. Dependent Variable: Annual Turnover
b. Predictors: (Constant), equity, internal source, external source, Retained earnings

b. Regression Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	3.679	1.223		3.009	.005
	Retained earnings	-.251	.364	-.124	-.691	.494
1	Internal source	-.030	.265	-.019	-.113	.911
	External source	-.039	.342	-.020	-.113	.911
	Equity	.313	.290	.200	1.080	.288

a. Dependent Variable: Annual Turnover

The model summary Table 1a shows that there is no statistically significant relationship between turnover and capital structure (Sig.> 0.05) and none of the predictors (retained earnings, internal source, external source and equity) were significant (table 1c) except for equity. This meaning that majority of the traders rely on equity or personal fund in starting up the business. However, the null hypothesis was accepted since p>0.05, thus there is no significant relationship between capital structure and growth of SMEs trading in building materials. These result is consistent with Muiru and Kamau (2014) who studied capital structure decisions by SMEs in Kenya .

Conclusion and Recommendations

The result of the findings shows that no significant relationship exit between capital structure of Igbo men trading in Building materials and the growth of their firms. This also support the pecking order theory of capital structure which says that there does not exist an optimum leverage for firms. As a result, the pecking order theory shows a negative relationship between leverage and profitability.

The recommendations to managers of SMEs is that they should not focus only on capital structure of firms but other financial management variables should be considered so as to know factors that can enhance the growth of these firms. The involvement of financial manager should also be a top most priority for these firms and lastly, a larger survey should be carried out among this group of people with a consideration of other financial management variables.

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